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Max Nathan Jr.

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THE COLLATERAL MORTGAGE

Max Nathan, Jr.* and H. Gayle Marshall**

Mortgage is one of the most desirable and powerful security interests that can be granted creditors, conferring as it does the power to have the mortgaged property seized and sold and the proceeds of the sale applied to satisfy the debt with preference and priority over other creditors.¹ Properly handled, the mortgage not only confers priority as to the proceeds of sale but the mortgagee can pursue the property and preserve his rights even if ownership is transferred to a third person.² Lacking the disadvantage of pledge, namely dispossession of the debtor, and having the advantage of very stable security such as immovables,³ mortgage is a security device favored by borrowers and lenders alike.

Although the Louisiana Civil Code describes mortgages as being either conventional, legal or judicial,⁴ there are in fact several kinds of conventional mortgages. The Code itself recognizes the ordinary conventional mortgage,⁵ granted for a specific debt, and the mortgage to secure future advances.⁶ In both instances, the mortgage is an accessory obligation, dependent upon an underlying valid principal obligation for its existence.⁷ Both the ordinary conventional mortgage and the mortgage to secure future advances, of course, are special forms of conventional mortgages⁸ and arise only by contract.

* Associate Professor of Law, Tulane University; Member, New Orleans Bar.

** Member, Lake Charles Bar.

1. LA. CIV. CODE art. 3278.

2. See generally LA. CODE CIV. P. arts. 1092, 2335-43, 2371-81, 2643, 3721-43, 5154.

3. The collateral mortgage may be used in the mortgage of chattels also. See generally LA. R.S. 9:5351-56 (1950).

4. LA. CIV. CODE art. 3287.

5. LA. CIV. CODE arts. 3290-91.

6. LA. CIV. CODE arts. 3292-93. See also LA. R.S. 9:4801 which subordinates private works privileges to mortgages for future advances when "the mortgage has been recorded and the note delivered to the lender before any work or labor has begun . . ."

7. LA. CIV. CODE art. 3284.

8. The legal mortgage and the judicial mortgage are general mortgages, which means that they do not require a description of particular property but apply to all immovables of the debtor, then owned or thereafter acquired. LA. CIV. CODE arts. 3320, 3328. They do not arise by contract, but by operation of law. Conventional mortgages, however, can only arise by contract and, being special mortgages, can only cover particular property described in the act of mortgage. LA. CIV. CODE arts. 3305-06.

The Louisiana jurisprudence has spawned a third kind of conventional mortgage, the "collateral mortgage," described most succinctly by Professor Harry Sachse as "the strange alchemy of the pledge of a mortgage created by the pledgor."⁹ Historically, the ordinary conventional mortgage that secures a stated present advance was the first mortgage-type security device to be utilized in Louisiana legal and banking practice.¹⁰ In response to the needs of a society rapidly developing into a commercial state, faced with the limited commercial possibilities of the ordinary conventional mortgage, and as a concession to the commercial establishment, the redactors of the Louisiana Civil Code of 1825 drafted two new articles sanctioning a mortgage that would secure future advances.¹¹ To overcome certain limitations of this codal mortgage to secure future advances, however, Louisiana practitioners developed the collateral mortgage.¹² As its very name implies, the collateral mortgage is not designed directly to secure an existing debt, like the ordinary conventional mortgage, nor necessarily to secure advances to be made, like the mortgage to secure future advances, but instead to create a mortgage note that can be pledged as collateral security for either a pre-existing debt, or for a debt created contemporaneously with the mortgage, or for a future debt or debts, or even for a series of debts. Because the collateral mortgage departs from recognized mortgage concepts, but at the same time relies upon mortgage concepts; because it is used for specific present debts and for unspecified future debts; but mostly because of the weird blend of pledge and mortgage, drawing upon both for its efficacy but not fully on either, the collateral mortgage has been a source of unfortunate confusion and bizarre litigation. Consequently, despite its extraordinary commercial importance and utility, the collateral mortgage has been and is frequently misunderstood. The authors believe that familiarity

9. Sachse, *Report to the Louisiana Law Institute on Article Nine of the Uniform Commercial Code*, 41 TUL. L. REV. 785, 799 (1967).

10. See Code Napoleon arts. 2114-20 (1804); 2 M. PLANIOL & G. RIPERT, *Treatise on the Civil Law* nos. 2308-22, 2645, 2656-61 (11th ed. La. St. L. Inst. transl. 1959).

11. LA. CIV. CODE arts. 3259-60 (1825). These two articles were carried into the Civil Code of 1870 as articles 3292 and 3293, respectively.

12. The collateral mortgage was recognized in the following early cases: *Levy v. Ford*, 41 La. Ann. 873, 6 So. 671 (1880); *Merchants' Mut. Ins. Co. v. Jamison*, 25 La. Ann. 364 (1873); *Succession of Dolhande*, 21 La. Ann. 3 (1869).

with the device will breed clarity, not contempt, and hope by this article to dispel some of the unnecessary confusion.

MECHANICS FOR CREATION OF COLLATERAL MORTGAGE

Act of Mortgage

The first step in the creation and granting of a collateral mortgage is for the mortgagor to execute an act of mortgage, acknowledging an indebtedness in the act of mortgage, and stating that he intends to use the "mortgage note" to raise funds. The mortgage is drawn in favor of any future holder or holders of the "mortgage note," who are represented in the act of mortgage by a nominal mortgagee. For illustration, the following language, while not sacrosanct, may be found in many collateral mortgages:

"Which said appearer declared unto me, Notary, that desiring to secure funds from any person, firm or corporation willing to loan same, and for such purpose said Mortgagor does by these presents declare and acknowledge a debt in the sum of ONE MILLION ONE HUNDRED THOUSAND AND NO/100 (\$1,100,000.00) DOLLARS, and to evidence such indebtedness has executed under date of these presents one (1) certain promissory note for the said sum of ONE MILLION ONE HUNDRED THOUSAND AND NO/100 (\$1,100,000.00) DOLLARS, made payable to the order of BEARER, on demand, at 1010 Common Street, New Orleans, Louisiana, which said note stipulates to bear interest at the rate of eight (8%) per cent per annum from date until paid, which said note after having been paraphed "ne varietur" by me, Notary, for identification herewith, was delivered to the said Mortgagor, who acknowledged receipt thereof, and said Mortgagor further declared that said note would be negotiated for the purpose of raising funds as heretofore stated, and said mortgagor does by these presents acknowledge to be indebted unto any future holder or holders of said note in the full amount thereof, together with interest, attorney's fees, insurance premiums, taxes and costs, if any should accrue."¹³

13. Some practitioners use the following language in the preparation of collateral mortgages: "And here the said mortgagor declared that this mortgage is executed and granted for the equal benefit and security of

Although the ranking of the collateral mortgage is not determined by date of filing or recordation in the parish mortgage records, as will be discussed later, it goes without saying that the act of mortgage must be recorded in order to affect third parties.¹⁴ Recordation is generally made as promptly as possible after execution of the act of mortgage.

"Ne Varietur" Note

In conjunction with the act of mortgage, the mortgagor executes a promissory note that is generally payable to "Bearer," although it may be payable to his own order and endorsed by him.¹⁵ The promissory note is then paraphed "ne varietur" by the notary public for identification with the act of collateral mortgage. Although all practitioners will understand the phrase "paraphed 'ne varietur,'" many students have had difficulty with the concept of paraphing a note, as well as the use of the term "ne varietur." The words "ne varietur" come from Latin and simply mean "it must not be altered." Paraphing means that the notary public signs the promissory note with his official signature, thereby certifying its genuineness, and marks or writes on it an inscription similar to the following:

"Ne Varietur for identification with an Act
of Collateral Mortgage passed before me this
_____ day of _____, 19____.
s/ Notary Public "

Paraphing, then, is nothing more than the Notary's act of signing

any and all future holder or holders of the hereinabove described note at whatever period or for whatever cause or for any reason whatsoever said note may be issued or reissued, the purpose of the present act being to enable said mortgagor to pledge, pawn, hypothecate and deliver, on such terms as said mortgagor may deem advisable and proper, the said note as collateral security to secure such loan or loans as said mortgagor may from time to time desire to make. It is understood and agreed that possession of the said note at any time by the said mortgagor herein shall not in any manner extinguish the said note or this mortgage, and the mortgagor shall have the right to issue and reissue the said note from time to time as his interest or conveniences may require, without in any manner extinguishing or affecting the obligation of said note or the security of this mortgage."

14. LA. CIV. CODE art. 3342; *McDuffie v. Walker*, 125 La. 152, 51 So. 100 (1909).

15. The note may be payable to some nominal holder, although this is not customary. A major purpose in having the note as bearer paper is that it can then be transferred without requiring an authentic act, which would otherwise be essential in order to obtain executory process. See LA. CODE CIV. P. art. 2835, comment (d).

and marking or writing on the promissory note.^{15A} By paraphing the promissory note "ne varietur," the notary makes it inextricably bound with and identified with the act of mortgage so that the note thereby incorporates all the terms and conditions of the mortgage and certifies that it is genuine.¹⁶

Acceptance

A nominal holder (usually a secretary in the notary's office) appears and accepts the mortgage for all future holders. As a practical matter, the note is delivered to the mortgagor, who will subsequently pledge it to secure a debt, but to avoid any problem of extinction of the mortgage, someone should technically accept the mortgage on the terms and conditions shown, namely that the note will be negotiated and used as collateral. To represent any future holders of the note and accept for them, a secretary is always convenient, but she obviously has no real interest in the transaction.¹⁷

Pledge of the "Ne Varietur" Note

The next step is critical in the confection of the total (and completed) security device, being the stage at which pledge

15A. Technically, as used in Louisiana law, the word "paraph" means the official signature of the notary public. See *Harz v. Gowland*, 126 La. 674, 52 So. 986 (1910). The word has an interesting origin. It is derived from the French "parafe" or "paraphe," and is a contraction of the word "paragraphe." As a noun, the French "parafe" or "paraphe" refers to a flourish after one's signature; as an infinitive, "parafer" or "parapher" means to put one's flourish, dash or initials to something. See CASSELL'S NEW FRENCH DICTIONARY, 5th ed. (1951), p. 517. As originally used, the flourish at the end of the signature was a safeguard against forgery. Similarly, "[t]he paraph [of the notary public] is the official signature, and evidence of the reality and genuineness of the note on which it is written." *Harz v. Gowland*, 126 La. at 678. See article 3384, Louisiana Civil Code of 1870, which requires the notary's signature and the inscription of identification.

16. In the ordinary conventional mortgage, the "ne varietur" note would be the evidence of the debt and any payments made on the debt should be marked on the face of the note and the amount of the indebtedness thereby reduced. With the collateral mortgage, however, the execution of the "ne varietur" note, and the paraphing of that note by the notary, are only the second step in the series of steps. Another reason to paraph the note is that the note is then in authentic form and can be used for executory process. See *Reed v. Meaux*, 262 So.2d 570 (La. App. 3d Cir. 1972). See also note 18 *infra*.

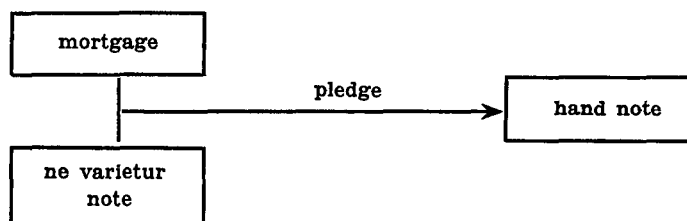
17. Amusingly, one young lawyer advised the authors that when he first started practice he encountered a number of collateral mortgages, all of which showed a secretary in the office as the first mortgagee. He was dismayed to learn later that she was not a wealthy lender at all but only a nominee.

enters the picture. The collateral mortgage note, i.e., the "ne varietur" note, is not the indebtedness; it is merely the security that will be pledged as collateral for the true debt. Consequently, the next step is for the mortgagor to become also a pledgor: he pledges the "ne varietur" note and the act of mortgage itself to the creditor to secure a debt. This debt is evidenced by what is commonly called a "hand note" that contains appropriate provisions to be secured by pledge. Thus, the "hand note" will contain all of the customary clauses and conditions for pledge and at some point on the hand note there will be language substantially similar to the following:

"This note is secured by the pledge of one certain Collateral Mortgage note executed by John Doe as Mortgagor before Frank Roe, Notary Public, dated _____."

The evidence of indebtedness, then, is not the collateral mortgage note ("ne varietur" note), but the hand note behind which the collateral mortgage note is pledged.¹⁸

18. A diagram of the collateral mortgage transaction is as follows:



The "ne varietur" note and mortgage are pledged to secure the hand note. [Editor's Note. See Professor Crawford's article in this issue for discussion of the hand note as the evidence of the indebtedness.]

Subsequent to the submission of the draft of this article, the First Circuit Court of Appeal decided the case of *Sudell Building Supply, Inc. v. I.D.S. Mortgage Corp.*, 273 So.2d 343, writs denied, 274 So.2d 708 (1973), which was a suit to annul an order of seizure and sale of mortgaged property under executory process. The mortgage was a collateral mortgage, and the mortgagor challenged the order of seizure and sale on the ground that the hand notes should have been presented for the purpose of proving the debt and that executory process was improper since the hand notes were not authentic. Article 2635 of the Code of Civil Procedure, requires all evidence to prove the right to executory process to be authentic, and states that one such exhibit shall be "the note, bond, or other instrument evidencing the obligation secured by the mortgage or privilege . . ." It was contended that since the hand notes evidence the actual obligation, (as pointed out in this article), they should be presented and should be authentic. The Court rejected this argument and held that the collateral mortgage ("ne varietur") note is "the instrument evidencing the obligation secured by the mortgage." A similar conclusion was reached in *Scarborough*

Coordination of Notes

Obviously, this use of multiple notes can give rise to problems, and the careful lender will be sure that certain terms and conditions of the collateral mortgage note co-ordinate with corresponding terms and conditions of the hand note. For example, if the collateral mortgage note provides for attorney's fees, but the hand note does not, the lender is not entitled to recover attorney's fees.¹⁹ The careful attorney will make sure that the provision for attorney's fees in the "ne varietur" note co-ordinates with the provision for attorney's fees in the hand note; and, obviously, if the attorney's fees are fixed as a percentage of the amount claimed, the percentages should co-ordinate. Similarly, there may be a discrepancy in interest rates. If the "ne varietur" note provides for 10% interest, but the hand note behind which the "ne varietur" note is pledged provides only for 8% interest, then the creditor is entitled to recover and is secured only to the extent of the 8% interest rate. The hand note is the evidence of the debt, and the "ne varietur" note is the collateral security, so that co-ordination is essential: if the term (e.g., attorney's fees) is provided for in the hand note, but not in the "ne varietur" note, then the creditor is entitled to recover, but is not secured, as to that item; if the term is provided for in the "ne varietur" note, but not in the hand note, then the creditor is not only unsecured, but not entitled to recover that particular item because it is not part of the debt.^{19A}

v. Duke, 251 So.2d 55 (La. App. 3d Cir. 1971). The result, we think, is correct and it is not inconsistent with the analysis of this article. The hand note is the actual indebtedness. But the mortgage note is the instrument "secured by the mortgage." Again, one must view the collateral mortgage as a total security device and not merely one aspect of the device. The Code of Civil Procedure does not require authentic form for the "instrument evidencing the obligation," which would be the hand note, but for the "instrument evidencing the obligation secured by the mortgage," and that instrument is the mortgage note, not the hand note. The court's conclusion in *Slidell Building Supply*, right or wrong so far as executory process is concerned, is not inconsistent with the analysis of the collateral mortgage in this article. The court's conclusion is in fact consistent with our analysis viewing the collateral mortgage as a whole: one can legitimately read article 2635 of the Code of Civil Procedure as not requiring the hand note to be authentic and yet recognize that the hand note evidences the debt, while the collateral evidences the obligation secured by the mortgage. See also *Cameron State Bank v. Duhon*, 263 So.2d 433 (La. App. 3d Cir. 1972).

19. See *Odom v. Cherokee Homes, Inc.*, 165 So.2d 855, 871-73 (La. App. 4th Cir.), writs denied, 246 La. 867, 167 So.2d 677 (1964).

19A. It is of course not uncommon in practice for the act of mortgage and "ne varietur" note to be for an amount greater than the amount that

Issuance and Reissuance

The pledge of the "ne varietur" note to secure the hand note is commonly referred to as "issuance." The term "issuance" is important for, unlike the ordinary conventional mortgage that is effective upon filing in the mortgage office (if it is actually and promptly recorded thereafter)²⁰ the act of collateral mortgage may be recorded and remain dormant for months, if not years, and only obtains ranking against third parties from the time of "issuance," i.e., when the "ne varietur" note is pledged to secure the debt.²¹ Also, unlike the ordinary conventional mortgage, when the debt is paid, and the hand note is marked "paid," and the hand note and the "ne varietur" note are returned to the mortgagor-pledgor, the collateral mortgage is not extinguished. The mortgage does, however, lose its original ranking and becomes dormant.²² If the pledgor-mortgagor desires to borrow money and use the security of the collateral mortgage again, he can execute another hand note and secure it by pledge of the "ne varietur" note, exactly as he did the first time; the difference is that second and subsequent pledges of the "ne varietur" note are called "reissuance," and the collateral mortgage obtains a new rank: the date of reissuance.

The procedure of pledging one note to secure another note illustrates that the collateral mortgage is an exception to the rule that mortgage is an accessory obligation.²³ In the ordinary

the mortgagor intends to borrow. For example, the mortgagor may create a mortgage for \$50,000 but only borrow \$35,000. Obviously, the debt can only be enforced for the true indebtedness, here \$35,000. Also, in commercial practice, it is common for the mortgage and "ne varietur" note to stipulate a higher rate of interest than may be stipulated in the initial loan or hand notes. Clearly, the creditor can only recover and is only secured for the interest provided in the hand note. But the higher amount and higher interest rate in the mortgage protect the creditor if he later advances more funds or if interest rates rise. For example, the collateral mortgage may provide 10% interest, but at the outset the borrower only borrows at the rate of 8%. In a period of rising interest rates the parties could increase the effective rate of interest simply by new hand notes rather than continually cancelling old and re-executing new acts of mortgage each time the interest rate changes.

20. *Kinnebrew v. Tri-Con Prod. Corp.*, 224 La. 879, 154 So.2d 433 (1963); *Opelousas Fin. Co. v. Reddell*, 119 So. 770 (La. App. 1st Cir. 1929); *see also* Note, 1 La. L. Rev. 231 (1938).

21. *Odom v. Cherokee Homes, Inc.*, 165 So.2d 855, 865 (La. App. 4th Cir.), *writs denied*, 246 La. 867, 167 So.2d 667 (1964).

22. *See, e.g., Morris v. Executors of Cain*, 39 La. Ann. 712, 1 So. 797 (1887).

23. *See* LA. CIV. CODE art. 3284.

conventional mortgage there is an act of mortgage and a promissory note paraphrased "*ne varietur*" for identification with the act of mortgage, and *that* note itself is the principal obligation secured by the accessory obligation of the mortgage. In the collateral mortgage situation, the "*ne varietur*" note is not the indebtedness at all; the "*ne varietur*" note, rather, is only to be used as collateral, the security that is pledged to the creditor to secure another note. The true indebtedness is the debt that the collateral mortgage "*ne varietur*" note is pledged to secure. Thus, while the "*ne varietur*" note is generally a note payable on demand, it does not represent a specific debt. It may be pledged behind another demand note; it may be pledged behind a term note that would not mature until a specified date; or it may well be pledged behind a hand note that is payable in installments. But, in any event, the terms and conditions of the hand note represent the indebtedness and govern the payment schedule for the borrower.

Because the hand note is the true evidence of indebtedness, and the "*ne varietur*" note is merely collateral, any payments that are made by the borrower to the lender are applied directly to the hand note, and not to the "*ne varietur*" note. Assuming that the borrower has executed an act of collateral mortgage for an amount "up to" the sum of \$50,000, the mortgage has been properly recorded, and the "*ne varietur*" note has been pledged to secure a loan of \$10,000, represented by a hand note in that amount, the creditor at this point is holding two notes; if he makes no further advances to the borrower, and the borrower begins to repay the loan, any payments that are made will be applied to the hand note and not to the "*ne varietur*" note. If payment of the \$10,000 plus interest is made in full, then the hand note is marked "paid" and both the hand note and the "*ne varietur*" note are returned to the borrower. But the "*ne varietur*" note is not marked in any way; it, too, is returned to the debtor and can then be used to cancel the mortgage or be reissued to secure another debt. In order to cancel the inscription of the mortgage, the debtor must present the "*ne varietur*" note to the recorder of mortgages, following the proper procedures for cancellation of an inscription of mortgage; the hand note is not recorded and obviously the mere presentation of a hand note marked "paid" would be insufficient to obtain can-

cellation of the inscription of the mortgage. In the ordinary conventional mortgage, however, payments made by the debtor to the creditor are applied to the "ne varietur" note, which is the evidence of the indebtedness, and such payments pro tanto reduce the indebtedness and to that extent extinguish the mortgage.

DISTINCTION BETWEEN EFFECT OF RECORDATION AND PRESCRIPTION

The basic procedures outlined above as the mechanics for the operation of the collateral mortgage give rise to some highly unusual legal characteristics unique to the collateral mortgage device. One area plays variations on the theme of prescription. At the outset it should be remembered that there is a distinct difference between effect of recordation and prescription, *i.e.*, between efficacy and ranking as to third persons based on the public records on the one hand, and prescription of the principal obligation on the other. Thus, the Civil Code provides in article 3369 that where the principal obligation secured by a mortgage matures in less than nine years, the recordation of the mortgage is effective as to third persons, for ranking purposes, for ten years, which ranking is lost if the mortgage is not reinscribed in the public records within the ten year period. If the principal obligation matures more than nine years from the date of the act, then the recordation of the inscription is effective, for ranking purposes, until six years after the maturity of the obligation. Article 3369, however, applies only with regard to efficacy as to third persons, and it clearly assumes a *valid* principal obligation. If the principal obligation has been extinguished, and the mortgage has thereby fallen, then article 3369 is no longer operative, much less relevant. In other words, a mortgage may be valid as between the parties, but have no effect as to third persons because of failure to inscribe or reinscribe; or, the obligation may be extinguished, in which event it would not have effect as to anyone regardless of recordation. By way of illustration, a person may execute an ordinary mortgage securing a demand note in the amount of \$10,000; under article 3369 the recordation of the mortgage would be effective as to third parties for a ten year period. If the mortgagor makes payments of interest on the demand note regularly for the entire ten year period, then the mortgage is still valid as between the

parties, and the full debt is viable and owing. But if the mortgagee fails to *reinscribe* the mortgage within the ten year period, then the mortgage is no longer effective as to third parties and would be primed by any intervening encumbrances. By the same token, if the mortgagor makes no payments of interest or principal and no other acknowledgment of the debt, since the prescriptive period on demand notes is five years from the date of the note, then five years after the execution of the note, the principal obligation would prescribe, and the mortgage would fall with it; article 3369 at that point becomes totally irrelevant and it does not matter that the mortgage is recorded. Since, in the collateral mortgage situation, the "ne varietur" note is almost invariably a demand note, the act of collateral mortgage should unquestionably be reinscribed within ten year periods in order to preserve efficacy as to third persons. Inscription and reinscription, however, as illustrated above, only concern effect as to third persons and have nothing whatsoever to do with the question of validity of the mortgage or prescription.

IMPREScriptIBILITY OF THE HAND NOTE

A unique advantage of the collateral mortgage device is that the "hand note," which is the true evidence of indebtedness, is imprescriptible. It is a well-recognized principle of Louisiana law that where a debt is secured by pledge, the holding of the pledged item by the creditor serves as a constant acknowledgment of the debt by the debtor so as to continually interrupt prescription.²⁴ Thus, in *Scott v. Corkern*,²⁵ where a promissory note was secured by the pledge of a life insurance policy, and nearly 30 years had passed with no payments or other acknowledgments of the debt, the court nonetheless found that the principal obligation had not prescribed because the existence of the pledge served continually to interrupt prescription.²⁶ Applying this legal principle, the pledge of the "ne varietur" note serves as a constant acknowledgment of the debt that is evidenced by the hand note and thereby continually interrupts prescription on the hand note. There is even jurisprudence to the effect that if one promissory note is pledged to secure another promissory note, and the note that is pledged prescribes, none-

24. See *Scott v. Corkern*, 231 La. 368, 91 So.2d 569 (1956).

25. *Id.*

26. *Id.* at 378, 91 So.2d at 572.

theless, the prescribed note will serve to continually interrupt prescription on the other note.²⁷ So long, then, as the creditor holds the "ne varietur" note in pledge behind the hand note, the hand note is imprescriptible.

PREScription OF THE "NE VARIETUR" NOTE

The "ne varietur" note itself *can* prescribe, and being a demand note, the prescriptive period on the "ne varietur" note is five years. For that reason, until recently, it has been the customary practice to have the mortgagor sign a written acknowledgement on the "ne varietur" note within five years after execution of the note (and thereafter to repeat the procedure within five year periods) to prevent prescription from running. If he failed to do so, the "ne varietur" note prescribed, and while the hand note would nonetheless remain a valid obligation, it would no longer be secured by a mortgage and would simply reflect an unsecured debt (not "unsecured" legally, but unsecured practically in the sense that the security is virtually worthless, being the pledge of a prescribed note). All too often lenders neglected or forgot (or were not advised) to obtain the written acknowledgement every five years, and found themselves holding prescribed mortgage notes. As a result, the Louisiana legislature enacted a special statute in 1970 to remedy the problem of prescription on notes such as the "ne varietur" note as it is used in the collateral mortgage situation. R.S. 9:5807 provides as follows:

"The partial payment of a promissory note by the maker thereof shall interrupt prescription upon any and all other promissory notes which have been pledged by said maker to secure the payment of the promissory note upon which the partial payment was made, if the pledged notes are held by the creditor to whom the partial payment was made, provided that in all such cases the creditor shall sustain the burden of proof that the pledged notes were in fact pledged to secure the note upon which the partial note [*sic*] was paid by the maker and that at the time of the partial pay-

27. Succession of Picard, 238 La. 455, 115 So.2d 817 (1959). In *Picard*, the court held that it is not necessary that the thing pledged have value, only that the thing be actually pledged. See also *Meyer Bros., Ltd. v. Colvin*, 122 La. 153, 47 So. 447 (1908).

ment the creditor receiving the partial payment was the holder of the pledged note or notes."²⁸

Heretofore, if *M* mortgaged Blackacre by collateral mortgage and pledged the "ne varietur" note to *P*, as *M* made payments to *P*, *P* would credit these payments on the hand note but not on the "ne varietur" note. While such payment would constitute an acknowledgment to interrupt prescription on the hand note, acknowledgment was unnecessary, because the hand note was already imprescriptible. If no payments were made or credited on the "ne varietur" note, or if there were no acknowledgment of it made, then five years after the execution of the mortgage and "ne varietur" note, the "ne varietur" note would prescribe.²⁹ Applying the language of R.S. 9:5807 to the collateral mortgage situation in the illustration given above, when *M* pledges the "ne varietur" note to *P* and makes payment to *P*, then the "partial payment" of the "promissory note" by *M*, "the maker thereof," would "interrupt prescription" on the "ne varietur" note, being an "other promissory note" which has been "pledged" by *M*, the maker, to secure the payment of the promissory note (hand note) upon which the partial payment was made. The sole proviso is that the "ne varietur" note (the pledged note) must be held by the creditor (*P*) to whom the partial payment is made; *P* must prove that the "ne varietur" note was in fact pledged to secure the hand note upon which payment was made and that *P* was the holder of both notes. R.S. 9:5807 fits the collateral mortgage situation like a glove, and was clearly intended to cover the very problem of prescription of the "ne varietur" note as outlined above. Unfortunately, the statute is not artfully drafted and may be overly broad. Being of recent vintage, the statute has not yet been tested in the courts. One can easily imagine the problems in its application. For example, suppose *M* does not pledge his own collateral mortgage "ne varietur" note when he borrows money from *P*, but rather pledges the note of another party, *e.g.*, a note from *D* that is made payable to *M*. When *M* makes payments to *P* on *M*'s debt to *P*, then, under the literal terms of the statute those payments would interrupt prescription on the note of *D* that is payable to *M*. The pledge of notes of third persons is not

28. LA. R.S. 9:5807 (Supp. 1970).

29. In practice, many creditors overlooked the requirement of such acknowledgment of the "ne varietur" note within five years, and many others were unaware of it.

uncommon in practice, but it is highly improbable that the Legislature intended to cover such situations by R.S. 9:5807. Nevertheless, under the literal terms of the statute, in the illustration of the pledge of a third person's note, the partial payment by *M* shall interrupt prescription "*upon any and all other promissory notes which have been pledged by said maker*" to secure the payment of the note upon which he makes partial payment. It is very doubtful, if not inconceivable, that the courts would strain the rules of prescription so far as to permit the interruption of prescription on a third person's obligation in such a fashion. Consequently, until the statute has been judicially construed and upheld, there is some danger that the statute, having been drafted overly broad, may be held invalid in the very area where it is needed, namely, to prevent prescription from running on the "*ne varietur*" note that has been pledged to secure a hand note, where both are notes of the same maker. Because of this potential danger area with R.S. 9:5807 judicially untested, the authors of this article recommend that unless and until the statute is construed and (hopefully) upheld by the courts, the best practice will be to continue to have the maker execute a written acknowledgment on the "*ne varietur*" note within the five year period from its execution and thereby obviate any question of prescription or reliance on the statute.

DISTINCTION FROM ORDINARY CONVENTIONAL MORTGAGE—
ABILITY TO REVIVE

The ordinary conventional mortgage is made to secure a specific debt, and the mortgage is identified with that debt, so that when the debt is paid, the mortgage expires.³⁰ The rule, of course, is merely a corollary of the principle that mortgage is an accessorial obligation requiring a valid principle obligation for its existence. And, unlike Lazarus, a mortgage that is extinguished cannot be revived. The rule is well settled in Louisiana jurisprudence that "when a mortgage is given for a specific debt to a particular creditor, payment of that debt extinguishes the mortgage and a reissue of the note will not revive or reinstate the mortgage."³¹ If the drawer reissues the note, he may be legally bound on the reissued note, but he cannot revive

30. LA. CIV. CODE art. 3285.

31. *Mente & Co. v. Levy*, 160 La. 496, 501, 107 So. 318, 320 (1926). See also LA. CIV. CODE art. 3285.

the accessorial obligation of mortgage.³² If, however, the mortgage is not for a specific debt, but for as yet undetermined future advances, and if the mortgage is in favor of any future holder, then the mortgage ("ne varietur") note may be returned to the maker, and the return does not cancel the mortgage. The note may be used as collateral and reissued for other and different debts, which acts revive and reinstate the mortgage.³³ When the collateral mortgage note is returned to the maker, the mortgage merely becomes dormant, not extinguished; it simply remains dormant until a reissue of the note.

DISTINCTION FROM ORDINARY CONVENTIONAL MORTGAGE—RANKING

Prior to 1910, a mortgage was not effective against third persons until it was actually recorded,³⁴ but in 1910 the Louisiana legislature enacted Act No. 215, sections 1 and 2, now R.S. 9:5141, which provides:

"All acts or instruments of writing which import mortgage or privilege, when filed for record with the Recorder of Mortgages, shall be immediately indorsed by him with the date, hour and minute of filing, which indorsement shall be recorded with the registry of the instrument.

"All such instruments shall be effective against all persons from the time of their filing." (Emphasis added.)

Undoubtedly, the statute was designed to place mortgages on the same footing with conveyances, which throughout Louisiana legal history have been effective against third persons from the time of their filing, even if never recorded.³⁵ But the act

32. *Hill v. Hill*, 4 Rob. 416 (La. 1843); *Succession of Phillips*, 49 La. Ann. 1019, 22 So. 202 (1897).

33. *Levy v. Ford*, 41 La. Ann. 873, 6 So. 671 (1889); *cf. Odom v. Cherokee Homes, Inc.*, 165 So.2d 855 (La. App. 4th Cir.), *writs denied*, 246 La. 867, 167 So.2d 677 (1964).

34. Until Act 215 of 1910 was passed the law was apparently settled that the use of the word "record" in a statute meant *actual* inscription, and, under this jurisprudence, article 3342 of the Louisiana Civil Code, providing that mortgages must be inscribed on the records to affect third parties, was interpreted by practitioners to mean that a mortgage was only effective against third persons after it was actually inscribed in the mortgage office of the parish where the property was located.

35. *See, e.g., Burgas v. Stoutz*, 174 La. 586, 141 So. 67 (1932); *Schneidau v. New Orleans Land Co.*, 132 La. 264, 61 So. 225 (1913); Note, 25 La. L. Rev. 783 (1955).

contains possible constitutional objections, because the Louisiana constitution provides that "[n]o mortgage or privilege on immovable property . . . shall affect third persons unless recorded or registered in the parish where the property is situated, in the manner and within the time prescribed by law"³⁶ In the two major cases that have interpreted and applied R.S. 9:5141, the courts have attempted to reconcile the statute's ranking provisions with the constitutional requirements by interpreting the statute to mean that the mortgage is effective *from the time of filing* in the mortgage office, provided that it is "promptly and actually" subsequently recorded, so that the actual recordation in the mortgage office books makes the efficacy retroactive to the date, hour and minute when the act was filed for recordation.³⁷ Thus, in the situation of the ordinary conventional mortgage, where the debt is either in existence or comes into existence at the same time as the execution of the mortgage, the mortgage is effective as to third persons from the time that the act of mortgage is filed for recordation, provided that it is thereafter promptly and actually recorded in the mortgage books. Since the general rule for ranking purposes is "first in time, first in rank," it is fairly easy to determine ranking priorities among ordinary conventional mortgages.³⁸ The collateral mortgage departs from this ranking scheme and, it must be admitted, contains significant elements of uncertainty. Unlike the ordinary conventional mortgage, the rank of the collateral mortgage cannot be determined by examination of the public records. Except for the fact that filing and recordation are essential for the mortgage to be effective as to third persons at all, neither filing nor recordation time determines rank; it is the date of issuance (or reissuance) of the "ne varietur" note

36. LA. CONST. art. XIX, § 19.

37. *Kinnebrew v. Tri-Con Prod. Corp.*, 224 La. 879, 154 So.2d 433 (1963) (mortgage actually inscribed three days after filing for recordation held effective from time of filing); *Opelousas Fin. Co. v. Reddell*, 119 So. 770 (La. App. 1st Cir. 1929) (failure of clerk to record mortgage act in the book of mortgages for a year and a half after filing, held not "prompt and actual" so that mortgage not effective until actually recorded). What constitutes "prompt and actual" lies somewhere, then, between three days, which is prompt, and a year and a half, which is not.

38. Parties can, of course, contractually agree to subordinate one mortgage to another, and thereby alter the ranking otherwise afforded by the public records. But the general rule nonetheless holds, and a person examining the public records can determine with a high degree of precision where a given encumbrance will rank vis-à-vis other ordinary conventional mortgages.

identified with the mortgage that determines the ranking of the collateral mortgage.

"The lien is regarded as being suspended insofar as third persons are concerned during any period in which the note remains unissued in the possession of the mortgagor or during any period between the extinguishment of a debt which the note is pledged to secure, and is repledged as security for another debt. The lien of the mortgage revives upon the repledge of the note and dates from that day."³⁹

The terms "issuance" and "reissuance" are, of course, terms of art, referring respectively to the first and subsequent pledges of the "ne varietur" note as collateral to secure the hand note. Even if the act of collateral mortgage is recorded, so that it could have effect against third parties, if the "ne varietur" note has not been issued (i.e., pledged to secure a hand note), then the mortgage lien remains suspended or dormant and any intervening creditors will prime the subsequent creditor who takes a pledge of the collateral mortgage note. The earlier recordation date of the collateral mortgage does not protect him. Similarly, if the act of collateral mortgage has been recorded and the "ne varietur" note has been issued (i.e., pledged to secure a hand note), and the hand note secured by pledge of the "ne varietur" note is paid and the "ne varietur" note returned to the maker, the collateral mortgage again becomes dormant. Although the collateral mortgage (unlike the ordinary conventional mortgage) may be revived and the "ne varietur" note may be reissued to secure other debts of the mortgagor, nonetheless in such case the collateral mortgage loses its former rank and the lien of the mortgage revives upon the reissuance (i.e., repledge) of the collateral mortgage note and dates and ranks from the time of reissuance. Since hand notes and pledges are not recorded, it is obviously impossible to tell from the public records whether the collateral mortgage is dormant or viable and if viable, its rank.

The problem of ranking from issuance or reissuance of the "ne varietur" note by its pledge is graphically illustrated in

39. *Odom v. Cherokee Homes, Inc.*, 165 So.2d 855, 865 (La. App. 4th Cir.), writs denied, 246 La. 867, 167 So.2d 677 (1964). See also the cases cited in *Odom*, 165 So.2d at 865, and Note, 25 LA. L. Rev. 789, 794 n.33.

*Odom v. Cherokee Homes, Inc.*⁴⁰ Cherokee was indebted to Morgan for \$114,000, which sum was secured by the pledge of four collateral mortgage notes in the aggregate face amount of \$220,000. The four acts of collateral mortgage had already been recorded and the notes issued when Cherokee later executed and recorded other mortgages on the same property. Odom advanced \$120,000, part of which paid Cherokee Homes' indebtedness to Morgan. Cherokee then pledged the four collateral mortgage notes to Odom to secure Cherokee's promissory note to Odom for \$120,000. Later, Odom instituted proceedings to enforce the collateral mortgages, and the various holders of the notes that were secured by the *subsequently recorded* mortgages (but granted prior to the "reissuance" of the four collateral mortgage notes to Odom) intervened and asserted priority over Odom. It is unclear what actually transpired in the attorney's office when Morgan was paid off and when Odom obtained the four collateral mortgage notes, but it is clear that Odom did not lend funds to Cherokee directly and have Cherokee pay off Morgan. It appears that on March 24, 1959, in the office of Morgan's attorney, Odom delivered two checks to Morgan's attorney, one payable to Morgan for \$114,000 and the other payable to certain trustees for \$6,000. In return, Odom received the four collateral mortgage notes. On the same day, Cherokee executed and delivered to Odom a hand note for \$120,000, secured by pledge of the four collateral mortgage notes. There was no evidence to indicate what happened to the hand note, if in fact there ever was a hand note, held by Morgan and secured by the first pledge of the four collateral mortgage notes. In any event, if such a hand note or notes did exist, it or they were *not* assigned by Morgan to Odom. Nevertheless, Odom contended that the transaction was a "purchase" by him of the collateral held by Morgan. The intervenors contended that the transaction was a loan by Odom to Cherokee, with which Cherokee repaid its indebtedness to Morgan. The court properly found that Odom was acting for Cherokee when he paid Morgan and received the collateral, as a result of which the debt of Cherokee to Morgan was extinguished.

Odom could not have purchased the collateral mortgage

40. 165 So.2d 855 (La. App. 4th Cir.), *writs denied*, 246 La. 867, 167 So.2d 677 (1964).

notes, because Morgan did not own the collateral mortgage notes but held them in pledge as security for Cherokee's indebtedness to him; obviously, Morgan could not sell something he did not own.⁴¹ Furthermore, Odom was "hoisted by his own petard" because he filed suit as *pledgee* of the collateral mortgage notes, a position obviously inconsistent with the contention that he had purchased them. What Odom should have purchased was the primary indebtedness. Thus, if there had been hand notes as evidence of the primary indebtedness, and Odom had purchased the hand notes, then the primary indebtedness would have been transferred to him, and that transfer would have carried with it the pledged collateral. But, as observed earlier, there was no evidence to indicate that there ever were any hand notes representing Cherokee's indebtedness to Morgan, and clearly none was transferred to Odom. The court, finding that there was not a purchase of the primary indebtedness, but rather that the debt of Cherokee to Morgan was extinguished, found it immaterial whether the collateral mortgage notes were delivered to Cherokee and then delivered by Cherokee to Odom. Since pledge is an accessory obligation and cannot exist without a primary obligation,⁴² when the debt of Cherokee to Morgan was paid, Morgan's pledge obviously ceased to exist. The court properly found that at that instant "the pledged mortgage notes constructively came into the hands of the corporation."⁴³ That being the case, the subsequent repledge of the collateral mortgage notes by Cherokee, as security for the \$120,000 note that it gave to Odom, constituted a "reissuance" of the notes by Cherokee Homes, with the inevitable result that the lien of the collateral mortgage ranked from the date of reissuance and repledge of the notes to Odom, and not from the dates of the original issuances to Morgan.

The jurisprudence has not exactly been littered with cases involving collateral mortgages, and while *Odom* clearly illustrates an example of extinction of one obligation and reissuance of the "ne varietur" notes so as to establish a later ranking

41. LA. CIV. CODE arts. 2452, 3165. Of course, if the principal obligation had been due, and the act of pledge authorized a private sale of the collateral, then Morgan could have disposed of the pledged collateral. See LA. CIV. CODE art. 3158. However, since the primary obligation of Cherokee to Morgan was not in default, Morgan could not sell the pledged collateral.

42. LA. CIV. CODE art. 1771.

43. 165 So.2d 855 at 865.

date, what actually constitutes "reissuance" has not been fully clarified. Until 1972, for example, it was not determined whether, when *M* pledges his "ne varietur" note to *P* to secure a hand note and *M* subsequently pays the debt to *P* in full, but *P* retains the "ne varietur" note and subsequently advances more funds and *M* executes additional hand notes, such subsequent advances constitute "reissuance." In 1952, to remove some of the uncertainty as to ranking intervening encumbrances and such problems of "reissuance," the legislature enacted Act 290, which amended Civil Code article 3158 to provide in part:

"[I]t is further provided that whenever a pledge of any instrument or item of the kind listed in this article is made to secure a particular loan or debt, or to secure advances to be made up to a certain amount, and, if so desires or provided, to secure any other obligations or liabilities of the pledger to the pledgee, then existing or thereafter arising, up to the limit of the pledge, and the pledged instrument or item remains and has remained in the hands of the pledgee, the instrument or item may remain in pledge to the pledgee or, without withdrawal from the hands of the pledgee, be repledged to the pledgee to secure at any time any renewal or renewals of the original loan or any part thereof, or any new or additional loans, even though the original loan has been reduced or paid, up to the total limit which it was agreed should be secured by the pledge, and if so desired or provided, to secure any other obligations or liabilities of the pledger to the pledgee, then existing or thereafter arising, up to the limit of the pledge, without any added notification or other formality, and the pledge shall be valid as well against third persons as against the pledger thereof, if made in good faith; . . ."

Commenting on the amendment to article 3158, Harry Sachse observed in 1967 that "[I]f the statute is to be given effect, pledge, whether involving a collateral mortgage or not, can now freely be used to secure future advances, obligatory or not. The date for ranking will be the date of the pledge, not the date of the advance."⁴⁴

44. Sachse, *Report to the Louisiana Law Institute on Article Nine of the Uniform Commercial Code*, 41 TUL. L. REV. 785, 798-99 (1967).

In 1972 the amendment was interpreted for the first time, and in *New Orleans Silversmiths, Inc. v. Toups*,⁴⁵ a Louisiana court held that article 3158 of the Louisiana Civil Code, as amended to authorize the "open-end" pledge, applies to the collateral mortgage situation, so that where subsequent advances are made by the same creditor, the subsequent advances rank from and relate back to the date of the initial issuance (i.e., pledge) of the "ne varietur" note to that creditor.⁴⁶ The decision, legally correct and commercially sound, not only clarifies this previously unresolved area but immeasurably strengthens the collateral mortgage as a flexible security device. In *Silversmiths*, the mortgagor executed the first collateral mortgage, in the amount of \$150,000 on June 16, 1967, but the "ne varietur" note was not pledged until six days later, on June 22, 1967, when it was pledged to the Hibernia National Bank to secure a hand note for \$75,000. Over one year later, the mortgagor executed a second collateral mortgage, in the amount of \$50,000, dated October 16, 1968, and on the same day the "ne varietur" note for the second collateral mortgage was pledged to New Orleans Silversmiths to secure a hand note representing a \$35,000 loan. Less than one month later, a corporation bearing the same name as the mortgagor borrowed \$30,000 from the Hibernia National Bank and the mortgagor personally endorsed the note representing the loan to the corporation. Later the same month, the corporation borrowed an additional \$35,000 from the Hibernia National Bank, and again the mortgagor personally endorsed the loan. Then, in December of 1968, the mortgagor, individually, renewed his original \$75,000 loan made on June 22, 1967. The loans were variously renewed, by execution of new notes, and ultimately in May and June of 1969, all of the prior loans of the mortgagor were consolidated and the "ne varietur" note paraphed for identification with the first collateral mortgage (June 16, 1967) was pledged to secure the consolidation of the prior loans. Using letter symbols, then, the classic hypothesis that law professors posited to twit their students, and the classic situation that plagued bank attorneys, was finally posed for resolution in the courts: *D* borrowed money from *A*, secured by pledge of collateral mortgage notes, and subsequently *D* borrowed money

45. 261 So.2d 252 (La. App. 4th Cir.), *cert. denied*, 262 La. 309, 263 So.2d 47 (1972), *noted in* 47 Tul. L. Rev. 211 (1972).

46. *Id.* at 254.

from *B* secured by a second and subsequently recorded collateral mortgage note; then, *D* paid off his loan to *A* and later borrowed more money from *A*, presumptively securing the subsequent advances from *A* by the pledge of the original collateral mortgage note. Was this a "reissuance"? If so, upon payment of the first advances, the lien of the mortgage was lost and it obtained a new ranking upon the reissuance. Or, did article 3158 govern so that as long as the same creditor made all of the advances and retained the "*ne varietur*" note, all of the advances related back to the original issuance? Or, thirdly, did article 3158 relate back to protect the initial creditor only to the extent of advances it had made up to the time of the intervening encumbrance?

New Orleans Silversmiths foreclosed on the October, 1968 second collateral mortgage, and at the foreclosure proceedings, the Hibernia Bank intervened and asserted its priority. Silversmiths admitted that it ranked behind the initial advance of \$75,000 by the Hibernia, dated June 22, 1967, which was the time when the first collateral mortgage became effective, but Silversmiths claimed priority over all other advances. The court first looked to the predicate of article 3158, which requires that there be a written pledge, delivery of the object in pledge, and good faith. Finding that the pledge was in writing, and that there had been delivery of the collateral (the "*ne varietur*" collateral mortgage note) to the creditor, and that the parties were in good faith, the court held that under the provisions of article 3158, the lien rights of the Hibernia National Bank reverted to June 22, 1967, the date of the first issuance of the June 16, 1967, collateral mortgage, and that all advances made by the Hibernia subsequent to that initial issuance, even though made *after* the October, 1968 mortgage and *after* the advances by New Orleans Silversmiths, nonetheless primed the October, 1968 mortgage held by Silversmiths.⁴⁷

Judge Lemmon dissented from the majority opinion, expressing the view that the collateral mortgage first became effective only to the extent of \$75,000, the amount of the initial loan, and that the mortgage did not become effective against third parties in an amount over \$75,000 until a point in time

47. *Id.* at 256.

after Silversmiths' mortgage had been inscribed in the mortgage records and had already taken effect itself.⁴⁸ In his view article 3158, which is an article for the ranking of pledges, is not an article which should rank mortgages. Noting that the thing pledged is the "ne varietur" note and not the land, Judge Lemmon then observed that the pledge would give a ranking preference on the note and not on land. The initial advance of \$75,000, as the "limit of the pledge" contemplated by article 3158, was the effective limit of the debt that was secured by the thing pledged, namely the "ne varietur" note. In other words, since the mortgage itself was not effective against third parties for more than \$75,000 at the time of the intervening encumbrance, the note secured by the mortgage, namely the "ne varietur" note, which is the "thing pledged," could not be effective to a greater extent.

The problem with the dissenting opinion, we suggest, is that it fails to take into account the hybrid nature of the collateral mortgage and its total character as a security device. The "ne varietur" note was paraphrased for identification with a collateral mortgage *up to* the amount of \$150,000 even though it was pledged initially to secure a first advance of only \$75,000. Suppose that instead of using a collateral mortgage note, the pledgor had pledged 1,000 shares of common stock of a company listed on the New York Stock Exchange, worth \$150,000, to secure a loan of \$75,000; then under Judge Lemmon's views in dissent, if the pledgee subsequently advanced an additional \$75,000, he would only be secured up to the sum of \$75,000, the initial advance. Article 3158 confers retrospective ranking to future advances back to the date of the initial pledge "up to the limit of the pledge." And one must not confuse "the limit of the pledge" with the "initial advance." Since one meaning of the word "pledge" is the very collateral itself that is pledged, one interpretive approach could be to look to the collateral itself. Whether the amount of the indebtedness is greater than or less than the value of the collateral, the privilege conferred by the pledge covers all of the collateral originally pledged, or in the example given, to all 1,000 shares (despite any fluctuations in their value). The one thousand shares could be considered the "limit of the pledge." But Judge Lemmon's view would result in affording retrospective ranking effectively to only one-half

48. *Id.*

of the collateral, or 500 shares. And the view is not in accord with the literal terms of article 3158, which provide that any additional loans and advances made even though the original loan has been reduced or paid "shall be secured by the collateral to the same extent as if they came into existence when the instrument or item was originally pledged."⁴⁹

One should not, however, summarily dismiss Judge Lemon's view in dissent that article 3158 does not rank mortgages (and hence does not rank the collateral mortgage). Article 3158 is in fact located in the section of the Civil Code on pledge and is a pledge-ranking article. A major part of the problem stems from the ambiguity in the phrase "up to the limit of the pledge" in article 3158, as the phrase is applied to collateral mortgages. The word "pledge" has several different meanings and usages in the Civil Code, which, of course, does not add to clarity. The word "pledge" is both a noun and a verb, and in the Code it refers both to the contract of pledge itself and to the collateral given as security under the contract.⁵⁰ The problem becomes more difficult because, while article 3158 twice refers to "the limit of the pledge," it also provides that, even if the loan is reduced or paid, the pledgee has the benefit of retrospective ranking "up to the total limit *which it was agreed* should be secured by the pledge." Pretermittting the collateral mortgage situation, and applying article 3158 to an ordinary open-end pledge, as, for example, a loan secured by pledge of corporate stock, the initial agreement of pledge (which could be an authentic act, an act under private signature, or even a hand note containing pledge provisions) might very well set the "limit of the pledge." Where future advances are contemplated, the agreement of pledge should contain a statement reflecting the intention of the parties in that regard. For the pledge creditor to obtain the "privilege" on the collateral and preference against third parties that pledge confers, the first paragraph of article 3158 requires that there be a "written instrument" that states "the amount of the *debt* intended to be secured thereby" and a description of the thing pledged. In an ordinary open-end pledge

49. LA. CIV. CODE art. 3158, *as amended* by La. Acts of 1952, No. 290.

50. R. SLOVENKO, TREATISE ON CREDITOR'S RIGHTS UNDER LOUISIANA CIVIL LAW 101 (1968).

situation, careful practice would dictate stating the upper limit of future advances in the initial agreement of pledge.⁵¹

But the collateral mortgage device is neither fully pledge nor fully mortgage. One must remember that it is a hybrid and to be effective it must employ both security devices. In the collateral mortgage, pledge *and* mortgage are inextricably bound together, since the device requires the pledge of a mortgage note. Without an act of mortgage, there can be no mortgage note; without a mortgage note, there is no collateral to be pledged; without the pledge of the note, the mortgage is dormant and there is no obligation secured by the mortgage. As the very name implies, the device contemplates that the mortgage note does not represent an actual debt but will be issued as collateral to secure such debts. And the ranking priorities of collateral mortgages are not geared to filing and recordation, as in the ordinary conventional mortgage, but rather to "issuance," i.e., pledge of the "ne varietur" note. Consequently, the only commercially reasonable way to view article 3158 as applied to the collateral mortgage device is to view "the limit of the pledge" as being the limit fixed by the act of collateral mortgage. From the inception, *that* amount is the amount up to which the mortgage can secure debts. The hand note represents merely the first advance in what might be a single advance situation or what might be a series of advances. The language used in the act of collateral mortgage expresses the intention to pledge and sets the total limit that can be secured by the pledge.⁵² Thus, in the unique situation of the collateral mortgage, odd as it may be, it is literally the act of mortgage that fixes the "limit of the pledge." The key to applying article 3158 to the collateral mortgage situation, which the authors submit is commercially

51. In this connection, article 3158 of the Louisiana Civil Code provides in part as follows: "[W]henever a pledge of any instrument . . . is made to secure a particular loan or debt, or to secure advances to be made up to a certain amount, and, if so desire to provide it, to secure any other obligations or liabilities of the pledger to the pledgee, then existing or thereafter arising, *up to the limit of the pledge*, and the pledged instrument or item remains and has remained in the hands of the pledgee, the instrument or item may remain in pledge to the pledgee or, without withdrawal from the hands of the pledgee, be repledged to the pledgee to secure at any time any renewal or renewals of the original loan or any pledge thereof or any new or additional loans, even though the original loan has been reduced or paid, *up to the total limit which it was agreed* could be secured by the pledge, . . ." (Emphasis added.)

52. See note 13 *supra*.

sound and legally correct, is to view the collateral mortgage device as a whole. As Justice Tate observed when the Louisiana supreme court denied writs in *Silversmiths*, one must take into consideration the jurisprudential development of the device based upon the pledge of the collateral mortgage note.⁵³

If the court had held otherwise than it did in *Silversmiths*, the holding would have emasculated article 3158, and it would, of course, have significantly weakened the utility of the collateral mortgage to secure fluctuating loan amounts. Obviously, the fact that a mortgage is executed in the amount of \$150,000 does not mean that, at a forced sale, the property covered by the mortgage will in fact produce proceeds of \$150,000. A mortgage may be for an amount less than the fair market value of the property covered by the mortgage, or it might well be greater. Similarly, stock or other securities may be pledged when the fair market value is \$150,000, but at the time of default on the loan, the stock may well be worth substantially less than that amount, or it may well be worth more. Thus, it would be futile to look to the "value" of the "ne varietur" note. The act of collateral mortgage sets a ceiling on the amount of the security device, as a mortgage on the land, but the actual indebtedness may be less or more than that amount. The key, of course, is that the collateral mortgage employs the pledging of mortgage notes to secure advances, and, under article 3158, after the initial pledge, all such advances by the same creditor relate back to the date of the first pledge to him and are secured by the same collateral (which in *Silversmiths* was a collateral mortgage up to \$150,000).

The commercial advantage of the decision is obvious: once the creditor has made an initial advance, secured by pledge of a collateral mortgage "ne varietur" note, he can safely thereafter make advances, and the debtor can reduce or even pay the loan in full, and additional advances may be made even after such partial reductions or full payment, with the creditor nonetheless retaining throughout the loan period the initial

53. 262 La. 309, 263 So.2d 47 (1972). A similar approach is taken by Professor Gerald LeVan in an excellent analysis of the *Silversmiths* decision. *The Work of the Louisiana Appellate Courts for the 1971-1972 Term—Security Devices*, 33 LA. L. REV. 228 (1973). He concludes by applauding the result as bringing "a new measure of comfort" to practitioners accustomed to the collateral mortgage. *Id.* at 233.

ranking date of the first advance. This priority relieves the creditor of the necessity of checking the public records each time an advance is to be made, as well as saving the parties additional paper work, time and expense. The major objection to the retrospective ranking afforded by article 3158 is the possibility of abuse and injury to innocent third parties. This kind of objection, even if valid, is best remedied by the legislature and not the courts since the terms of Act 290 of 1952, amending article 3158 and authorizing the "open-end" pledge, clearly apply to the collateral mortgage situation. But more important, the specific criticism ignores the fact that several bases must be touched before the retrospective protection afforded by article 3158 even comes into play: (1) the initial pledge must be properly confected, with the parties mutually agreeing at the time that the pledge will secure obligations or liabilities thereafter arising; (2) each succeeding loan must be specifically secured by a pledge of the original collateral; (3) the collateral must continuously remain in the hands of the pledgee; and (4) the parties must act *in good faith* at all times. If the creditor has complied with these prerequisites, then no "innocent" third party can be injured by the collateral mortgage any more than he can be injured by the ordinary mortgage to secure future advances. Since the act of collateral mortgage is recorded and part of the public records (an essential element of the mortgage's efficacy as to third parties), any third party who relies on the public records would know not only of the existence of the collateral mortgage, but would have full knowledge of its upper limit. Granted, a party examining the public records cannot know the exact amount of the debt, but the same can be said of the ordinary conventional mortgage; and any party examining the public records does know the ceiling of the collateral mortgage.

The most serious functional disadvantage of the collateral mortgage, as it is now used, is that the mortgage is invariably made in favor of a nominal party or any future holder or holders of the mortgage note (the nominal party generally being a secretary in the notary's office) so that a person examining the public records does not know who the lender actually is, *i.e.*, who holds the hand note. The public records do reveal the name of the notary public, however, who can easily be asked

for whose account the collateral mortgage was executed and who usually will be able to direct the third party to the present lender. Furthermore, the third party must know the name of the mortgagor and it is virtually inconceivable that the mortgagor will not know either who actually has possession of the "ne varietur" note or at least how he can be located.⁵⁴

DISTINCTION FROM ORDINARY MORTGAGE TO SECURE FUTURE ADVANCES

Because the collateral mortgage is commonly used to secure future advances, it is frequently confused with the "mortgage to secure future advances."⁵⁵ The Civil Code expressly authorizes a mortgage to be given for an obligation that is not yet in existence,⁵⁶ or in other words, a future obligation, and the Code provides that the rights of the mortgagee are realized only insofar as the promise is carried into effect.⁵⁷ But, if the parties contemplate future advances, and the future advances are in fact made, then the Code provides that the mortgage has a retroactive effect to the time of the contract.⁵⁸ The classic example of the ordinary mortgage to secure future advances is the agreement of a lending institution to advance funds in connection with the construction of a building; for example, homestead *A* agrees to advance \$50,000 for the construction of a house on property belonging to *B*, where *B* has entered into a building contract for the construction of the house by contractor *C*. The building contract provides for stage payments to the contractor, as the slab is poured, the roof constructed, the electrical and plumbing roughed in, and so forth. Homestead *A* agrees that it will advance the funds and make payments to the contractor

54. An ordinary conventional mortgage note pledged to "bearer" can be transferred by delivery, so one would not necessarily know the name of the holder of such a note from the face of the public records in this situation either. But no one suggests abolishing mortgages altogether or doing away with bearer notes as a result.

55. For example, Judge Regan, in his dissenting opinion in the court of appeal decision in *Thrift Funds Canal, Inc. v. Foy*, 242 So.2d 253, 257 (La. App. 4th Cir. 1971), states that "the Louisiana mortgage to secure future obligations is commonly referred to by the practitioner as a 'collateral mortgage'" Other writers have similarly confused the two mortgages.

56. LA. CIV. CODE art. 3292.

57. LA. CIV. CODE art. 3293.

58. *Id.* This undoubtedly means to the time of filing, if actually and promptly recorded, and not to the date of the act of mortgage, since the mortgage could not be effective as to third parties without filing.

as the various stages are met and certified as having been completed. Homestead A may take a mortgage on B's property at the same time that it commits itself to advance funds for the construction of the house. Of course, there is special legislation in addition to the Code to govern such a situation.⁵⁹ As each stage is completed by contractor C, homestead A advances to him the funds for that stage, and under the provisions of articles 3292 and 3293 of the Civil Code, the advances made by the homestead are secured by the mortgage originally granted and each advance relates back to the original date of the mortgage. This classic example represents a mortgage to secure *specific* future advances, and under the general rules of mortgages, if the mortgage debt is reduced, the mortgage is reduced *pro tanto* and cannot be thereafter increased. If the debt is paid off, such a mortgage is extinguished and cannot be revived.

Unfortunately, the Code itself does not distinguish between mortgages to secure specific future advances and mortgages to secure optional or facultative future advances.⁶⁰ On its face, the collateral mortgage indicates that it will be used to secure advances to be made in the future, but it does not indicate

59. See LA. R.S. 6:833 (Supp. 1970). See also LA. R.S. 9:5301-07 (1950); LA. R.S. 9:4801 (c) (Supp. 1972); LA. R.S. 3:207 (1950), which deal with ranking of various advances under pre-existing recorded security devices.

60. See, e.g., LA. CIV. CODE art. 3292 and *Pickersgill v. Brown*, 7 La. Ann. 297 (1852). In *Pickersgill*, the mortgage apparently secured an already existing debt as well as fluctuating balances on an open account. Both French commentators and Louisiana practitioners at one time criticized the mortgage to secure future advances. Some French authorities argued that if the mortgage-creditor (the obligor) was not obligated to make the advances, his obligation rested on a potestative condition. See *id.* at 307-11. See also F. LAURENT, PRINCIPES DE DROIT CIVIL FRANÇAIS § 527 (1878); M. TROPLONG, DROIT CIVIL FRANÇAIS §§ 477-80 (1833). Louisiana practitioners expanded this argument by asserting that such mortgages could only become effective upon fulfillment of the condition, i.e., the advance; therefore, the mortgage should rank only from the advance, the point in time when the mortgage comes into being. See, e.g., *Pickersgill v. Brown*, 7 La. Ann. 297, 316-17 (1852) (excerpted brief for rehearing). The French commentators who opposed such views argued that the principal obligation was not the act of advancing money, but the promise to advance embodied in the original contract. See Comment, 34 TUL. L. REV. 800, 806 (1960). The redactors of the Civil Code of 1825, by adding articles 3259 and 3260 of that Code, apparently intended to preclude further debate from arising in Louisiana. These articles were retained in the Code of 1870 as articles 3292 and 3293. If the mortgagee is not obligated to lend, however, there may still be a valid basis for reversion to the French arguments concerning potestative conditions; see, e.g., *In re York*, 30 F. Cas. 811, 812 (No. 18, 138) (C.C.D. La. 1870): "There was from the date of the contract opening the credit account, a reciprocal obligation. The creditor must make the promised advances, and the debtor must restore what sums he takes by virtue of the credit."

specific advances. Therefore, the collateral mortgage is not and cannot be considered a mortgage to secure future advances of the specific kind. The collateral mortgage obviously can be and is used as a mortgage to secure future advances of the unspecific variety, and by its very operation of pledging the "ne varietur" note, the collateral mortgage is designed for that purpose. But the collateral mortgage is much broader in purpose and in practice than use to secure unspecified future advances: it may, for example, be used to secure an obligation to perform, in which event the ultimate outcome might be no monetary debt at all. For example, the authors have used the collateral mortgage in place of a surety bond, where a contractor agreed to construct a building but was unable to obtain payment and performance bonds from a commercial surety. In place of these surety bonds, the contractor executed a collateral mortgage on his own home, and then, by a written act of pledge, pledged the "ne varietur" note to the owner up to a specified penal sum to protect the owner against liability arising from liens or failure to complete construction. As a practical matter, in one such case the contractor defaulted on his obligation, and after the full extent of the contractor's liability to the owner was determined, the owner foreclosed on the collateral mortgage.⁶¹ Thus, just as all goldfish are fish, but not all fish are goldfish, so all collateral mortgages may secure future obligations, but not all mortgages to secure future obligations are collateral mortgages.

The difficulty in precisely defining the mortgage to secure future advances has been compounded by the recent Louisiana supreme court decision in *Thrift Funds Canal, Inc. v. Foy*.⁶² In that case *M* granted a \$10,000 first mortgage to *A* on February 14, 1963, payable in monthly installments. Three years later, when the principal had been reduced to \$8,227, *M* borrowed more money from *A*, and at that time executed a promissory note for \$3,000, stating that "this note is secured by a mortgage executed under date of 2-14-63, together with the said mortgage note." More than two years later, December 19, 1968, *M* executed a second mortgage in favor of *B* on the same property, for a

61. *Smith v. Eugene*, Docket No. 479187 (Civil Dist. Ct., Orleans Parish, La.).

62. 261 La. 573, 260 So.2d 628 (1972).

debt in excess of \$16,000. At foreclosure proceedings, the court was required to evaluate the three alleged encumbrances:

1. The 1963 \$10,000 note, secured by a 1963 first mortgage.
2. The 1966 \$3,000 note, a "future advance" allegedly secured by the 1963 mortgage.
3. The 1968 \$16,000 note, secured by a recorded 1968 second mortgage.

The primary issue was whether B's second mortgage primed A's 1966 note, which was allegedly secured by the earlier mortgage.

The court of appeal held that since mortgages are *strictissimi juris* and cannot be extended or modified by analogy, the mortgage, to qualify as a mortgage to secure future advances, must expressly state that fact on its face.⁶³ The court noted that "nothing less will satisfy the security of the public records, ownership of property, and the process of finance."⁶⁴ Since the 1963 mortgage did not so state on its face, it did not qualify to secure future advances and more particularly the \$3,000 advance made three years after the mortgage. The Louisiana supreme court affirmed as to result, but for different reasons. In affirming and reaching the right result, the supreme court correctly noted that the 1963 mortgage could not be classified as a collateral mortgage because the mortgage secured a specific existing debt and possessed none of the formal characteristics of a collateral mortgage. So far, so good; but the court then enunciated principles that will unfortunately and undoubtedly create more confusion than certainty and may do serious damage to "the process of finance." The supreme court stated:

"It is true that, in order to secure a future debt, a mortgage need not express on its face that it is given for future advances. It may be phrased as security for an existing debt, when no debt in fact exists, and yet secure a later debt in accordance with the intention of the parties."⁶⁵ (Emphasis added.)

63. 242 So.2d 253, 256 (La. App. 4th Cir. 1971).

64. *Id.* The court held that *Walmsley v. Resweber*, 105 La. 522, 30 So. 5 (1901) had in effect overruled *Pickersgill v. Brown*, 8 La. Ann. 297 (1852), which held that a mortgage did not have to expressly state on its face that it was designed to secure future advances.

65. 261 La. at 582-83, 260 So.2d at 631, citing *Hortman-Salem Co. v. White*, 168 La. 1057, 123 So. 711 (1929); *Collins v. His Creditors*, 18 La. Ann. 235 (1866); *Pickersgill v. Brown*, 7 La. Ann. 297 (1852); Note, 25 LA. L. REV. 789, 791 (1965).

Notwithstanding this language, the court went on to hold:

"We find nothing in the present record, however, to show that, when the first mortgage was executed, the parties intended that it secure future advances. Quite to the contrary, the record reflects that it was designed only to secure an existing debt, a loan made contemporaneously with the execution of the mortgage."⁶⁶

Thus, concluding that the 1963 mortgage was one for a specific debt, the court properly applied the Louisiana law that "[a]fter a mortgage note for a specific debt has been paid, the mortgage is extinguished. No later advance on the note can revive the mortgage."⁶⁷

Justice Hamlin dissented, believing that the 1963 mortgage had been intended to secure additional advances, so that it could properly be classified as a mortgage to secure future advances.⁶⁸ Justice Dixon also dissented, stating the strongest and most cogent reason of all:

"The majority opinion creates more problems than it solves. It makes the rank of competing mortgages depend on the mental state of the parties at the time the oldest mortgage is executed Our holding implies that these loans are unsecured in the absence of parol evidence to establish the intent of the parties at the time the mortgage was executed."⁶⁹

The authors submit that the result reached in the case is correct, because the 1963 mortgage was clearly for a specific debt, having a "ne varietur" note that was payable in equal monthly installments, whereby the payment of each installment applied to accrued interest and reduced the principal pro tanto, and the funds were advanced at the time of the mortgage. On its face, the mortgage appeared to be for a specific, particular,

66. 216 La. at 584, 260 So.2d at 632.

67. *Id.* at 585, 260 So.2d at 632, *citing* LA. CIV. CODE arts. 3285, 3411 (4); *Baton Rouge Wood Prod. Inc. v. Ezell*, 251 La. 369, 204 So.2d 295 (1967); *LaCoste v. Hickey*, 203 La. 794, 14 So.2d 639 (1943); *Mente & Co. v. Levy*, 160 La. 496, 107 So.2d 318 (1926); *Hibernia Nat'l Bank v. Succession of Gragar*, 109 La. 677, 33 So. 728 (1903).

68. 261 La. at 586, 260 So.2d at 633.

69. *Id.* at 603-04, 260 So.2d at 639.

existing debt, so that partial payment of the mortgage installment note reduced the note pro tanto; as the debt was reduced, it could not thereafter be increased to prejudice junior mortgages.⁷⁰

Unless it is legislatively overruled or judicially reversed, *Thrift Funds* may completely vitiate any efficacy of the Public Records Doctrine as applied to ranking of mortgages. The decision lends itself to the interpretation that any mortgage on the public records may be a mortgage to secure future advances. Before or after *Thrift Funds*, there is no problem in identifying a collateral mortgage, which shows on its face that it is clearly intended as such. Nor should there be any problem in identifying the classic mortgage to secure future advances where the advances are specific and/or obligatory, as in the example given above of the homestead agreeing to advance funds as stages in construction are met. But for a century there has been a single case, *Pickersgill v. Brown*,⁷¹ studied religiously by generations of law students, which in a truncated opinion had stated in dictum that a mortgage need not state on its face that it is executed to secure future advances. The case has been continuously criticized, in opinions and in the legal literature, and it was arguable that it had been overruled by *Walmsley v. Resweber*.⁷² The point was, of course, arguable. No careful practitioner relied on *Pickersgill* as sound law, but it was, admittedly, comforting to have the dictum to fall back upon in the

70. LA. CIV. CODE art. 3377; *Boagni v. Wartelle*, 50 La. Ann. 128, 23 So. 206 (1897); *Schinkel v. Hanewinkel*, 19 La. Ann. 260 (1867).

71. 7 La. Ann. 297 (1852). In *Pickersgill*, a standard mortgage to secure future advances was given for a past indebtedness, a present loan, and future advances. An intervenor held another mortgage given after the first mortgage was recorded, but before all of the advances secured by it were made. The court held that the first mortgage primed the intervenor's mortgage because mortgages, under the hypothecary system of Louisiana, may be given to secure debts having no legal existence at the date of the mortgage. *Id.* at 307, 314. The court stated in dictum that even with respect to third parties, the mortgage need not express *on its face* that it is executed to secure future advances. *Id.* at 307. *Pickersgill* has been upheld even in recent years. See *Courshon v. Mauroner-Craddock, Inc.*, 219 So.2d 258 (La. App. 1st Cir. 1968), *cert. denied*, 253 La. 760, 219 So.2d 788 (1969).

72. 105 La. 522, 30 So. 5 (1901). In *Walmsley*, a collateral mortgage for \$3,000 secured six \$500 notes made payable to the mortgagor himself, who endorsed and pledged the notes as he ran up debts. The court held that the mortgage did not secure future advances because it did not state *on its face* that it was given for that purpose. The effect of this holding was that the mortgage ranked not from recordation, but from issuance of the separate notes.

event of trouble. While legal scholars debate over whether *Walmsley v. Resweber* did in fact overrule *Pickersgill v. Brown*, the authors respectfully submit that the court in *Thrift Funds* had an excellent opportunity to hold that the dictum in *Pickersgill* was overruled. Had it done so, the court would have created little or no hardship to scriveners drafting mortgages and at the same time the rule would add a desirable element of certainty and security to the Public Records Doctrine in this area. The better rule was stated in *Walmsley* as follows:

"True it is that between mortgagor and mortgagee a mortgage may be executed for advances to be made, and it may be that, as between them, although the mortgage does not contain the stipulation that it should regarding future advances, it may yet be construed to embrace them as a consideration; but, as between a transferee of a mortgage and a third person, the former cannot establish by parole a consideration not even hinted at in the act of mortgage, or in any writing."⁷³

It has been suggested that the Thrift Funds rule, upholding *Pickersgill* and authorizing a mortgage to secure future advances even though it contains no references to such advances, is commercially necessary.⁷⁴ It strikes the authors as incongruous to complain "of the serious functional disadvantages" of the collateral mortgage, and at the same time attempt to justify the rule that any mortgage can be a mortgage to secure future advances if the parties only *intended* it to be so.⁷⁵ One must ask: how does any third party examining the public records know what the original parties intended? The case will surely

73. 105 La. at 533, 30 So. at 10. LA. CIV. CODE art. 3290. For a general discussion of the conventional mortgage, see R. SLOVENKO, TREATISE ON CREDITORS' RIGHTS UNDER LOUISIANA CIVIL LAW 558-81 (1968).

74. It is reputed that a large number of presently outstanding loans are secured by mortgages given and recorded long before such loans were made, and that the mortgage instruments contain no references to the mortgagor's intent to secure future advances thereby. Although *Thrift Funds* has been affirmed, one prominent author suggests that such loans may be unsecured. He also contends that requiring the mortgage to recite that it secures future advances will not assist third persons in determining the amount of indebtedness secured by the mortgage at any given time. *The Work of the Louisiana Appellate Courts for the 1970-1971 Term—Security Devices*, 32 LA. L. REV. 233, 238, 240 (1972).

75. Like Humpty Dumpty, the mortgagee can say that when he uses a mortgage it means what he wants it to mean, nothing more and nothing less.

encourage creditors to attempt to lift themselves by their own bootstraps: any creditor who advances future funds after the mortgage can be expected to claim that the original intent was that the mortgage secure future advances; otherwise, he would not have made the future advances. Nor, we submit, would any great hardship be created if attorneys were required to insert a clause in the mortgage stating that the mortgage is designed to secure future advances. Instead, by virtually requiring, much less permitting, the use of parole evidence to vary written instruments regarding immovables, the court has introduced a kind of "Ouija board jurisprudence" and made the public records meaningless. Professor LeVan, in speaking of ordinary conventional mortgages to secure future advances, suggests, "to be safe, it will still be necessary to assume that the maximum indebtedness recited in the mortgage is presently outstanding."⁷⁶ His statement is not broad enough: under the Thrift Funds rule, it will now be necessary to make that assumption for virtually every mortgage on the public records.

The authors suggest that the rule of *Pickersgill v. Brown*, now upheld in *Thrift Funds Canal, Inc. v. Foy*, is an unfortunate rule and should be legislatively overruled. The reluctance to jurisprudentially overrule *Pickersgill* perhaps stems from the problem of possible retrospective effect of such a decision, thereby creating problems for mortgages that were executed in reliance on *Pickersgill*. Legislatively overruling *Thrift Funds* can make the rule apply prospectively only. Since the mortgage to secure future advances has a retrospective ranking (to the date of filing and recordation) that is superior to the ranking afforded collateral mortgages (based on "issuance"), it appears patently inequitable to permit virtually *any* mortgage to qualify as a mortgage to secure future advances, even if the mortgage does not so state on its face that it is so intended, and thereby obtain the earlier ranking date, but to deny that advantage to the collateral mortgage, which does show on its face that it will secure advances to be made in the future.

ADVANTAGES OF THE COLLATERAL MORTGAGE

Despite the alleged "serious functional disadvantages" of

76. *The Work of the Louisiana Appellate Courts for the 1970-1971 Term—Security Devices*, 32 LA. L. REV. 233, 240 (1972).

the collateral mortgage, the authors suggest that the collateral mortgage has numerous excellent functional advantages that would not be afforded creditors or debtors under a strict system of ordinary conventional mortgages for specific debts and ordinary conventional mortgages for specific future debts. Nor are the functional disadvantages that "serious." Inability to determine the identity of the mortgagee from the public records hardly appears to be a problem, since the same can be true of any mortgage, if the mortgagee merely transfers the note; at best, all that the public records can indicate is the identity of the initial mortgagee. Nor does it seem disadvantageous that the amount of the true indebtedness secured by the mortgage cannot be ascertained by examining the public records; no system in the civil law or the common law has the payment schedule on mortgages reflected on the public records, and the public records could not be expected to show how many installments have been paid, or how much reduction of principal has been made on the demand note. In other words, the function of the public records is to put third parties on notice of the fact that there is an encumbrance, and inscription of the mortgage does provide that information. It shows the ceiling, but it cannot be expected to show where one stands between the floor and the ceiling, nor can it be expected to show whether a note has prescribed or otherwise been extinguished. No system of laws can prevent an individual from attempting to defraud someone else if he wants to attempt fraud, but the fears that the collateral mortgage lends itself to efforts to defraud one's creditors seem unwarranted to the authors, because the very predicate of article 3158 is that the dealings must be "in good faith."

Finally, it hardly seems objectionable that a competing creditor should not be permitted to prime advances that the mortgagee makes after he receives *actual* knowledge of the perfection of the competing creditor's claims. Often it is the knowledge that he can safely make such future advances without fear of being primed by an intervening creditor that induces the mortgagee to enter into the credit transaction and make the initial advance. Both the borrower and the lender may make substantial commitments to numerous other parties, such as architects, engineers, contractors, investors, and so forth, in reliance on the loan commitment, and those parties in turn rely

on their commitments. But the fact that future advances may be definitely contemplated does not mean that the debts and amounts are definite. One reason the collateral mortgage is so useful is that it is the only safe security device when the borrower does not know at the outset the exact amounts of, or dates when, money will be needed. In the construction of large subdivisions, one rarely knows the time elements for completion of construction of the various units, nor the exact amounts of money that will be needed as there is development and sale and rental of properties; the collateral mortgage offers economy and flexibility to the borrower with relatively complete security to the creditor. In the simple example of the construction of a house, the homestead that agrees to advance funds in stage payments as the house is constructed would find itself in a most precarious situation if only half the funds had been advanced and the house was only half completed when an intervening creditor came into the picture, if the law permitted the intervening creditor's claim to prime the homestead's mortgage. Few surety companies would be willing to write payment and performance bonds on construction projects in such cases. The homestead makes its initial commitment with the understanding that it will have a first mortgage, the security for which will be a completed building; to permit the homestead's mortgage to be primed by intervening creditors would obviously expose the mortgagee's security to dissipation and inhibit many loans that might otherwise be made.

The unique advantage of the collateral mortgage lies basically in its flexibility. It can secure obligations other than money debts, which, of course, must be sooner or later translatable into sums of money. The exact amount of the obligation, or even whether the obligation will in fact mature into a money obligation at all, may be unknown at the outset. The collateral mortgage can afford adequate security to a creditor where the borrower does not know the exact amounts or dates when he will need money, and in situations where the sums may vary. The collateral mortgage can be used to secure specific future debts as well as unspecified future debts, and thus has broader commercial possibilities than the standard conventional mortgage. It can secure an open account with a creditor as to which there are fluctuating balances due to periodic debits and credits.

The collateral mortgage reduces paper work by permitting the same security to be used when a debtor changes creditors, since the mortgage is not extinguished by payment of the original debt, and it encourages continuous dealings between the original creditor and the debtor, thereby increasing the ease and flow of credit to the debtor. As noted earlier, the collateral mortgage may secure an existing obligation and it may be used to secure future advances, as a result of which in many instances it relieves expenses of executing a new mortgage where a new mortgage is not necessary, for example, where a mortgagor desires to borrow additional funds to add a room or garage to his home. The mortgagor can borrow such money from the mortgagee without having to engage in expensive new financing.

CONCLUSION

One who knows the rules and plays the game by those rules can use the collateral mortgage with complete confidence and security, and by the flexibility of the device it fills an enormous gap in the area of secured credit transactions. It would be most unfortunate for the collateral mortgage to be legislatively eradicated or judicially emasculated. Mortgage, as stated earlier, is one of the most powerful security devices and one of the most popular. The authors submit that, without serious functional disadvantages, and with numerous functional advantages, the collateral mortgage is and should be a welcome creature of the jurisprudence and the practitioner's art.